

IRS News Release

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National Taxpayer Advocate Delivers Annual Report to Congress; Focuses on Taxpayer Service, Collection and Preparer Regulation

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WASHINGTON — National Taxpayer Advocate Nina E. Olson today released her annual report to Congress, warning that increased demands on the IRS have eroded the agency's ability to meet taxpayer service needs and expressing concern that IRS collection practices are harming financially struggling taxpayers without producing significant revenue gains.

In the preface to the report, Olson noted that she is required by statute to identify taxpayer problems, but she wrote that "the IRS in many respects has had an extremely successful year." She cited, in particular, the IRS's success in implementing significant legislative changes designed to stimulate the economy in the midst of the filing season.

Among the key issues and themes identified in this year's report:

Telephone Service. The report designates the IRS's declining ability to answer telephone calls as the most serious problem facing taxpayers. Olson notes that the IRS has set a target for FY 2010 of answering only 71 percent of calls from taxpayers seeking to speak with a customer service representative about account questions, down from 83 percent in FY 2007.

"In other words, the IRS is planning to be unable to answer about three of every 10 calls it receives," Olson said, adding that the IRS expects those who get through will have to wait an average of 12 minutes. The report states that this projected level of service is barely above the level of 69 percent notched in 1998, when Congress passed the landmark IRS Restructuring and Reform Act due in large part to concerns about inadequate taxpayer service. "This level of service is unacceptable," Olson wrote.

Examination and Collection Issues. The report contains a detailed assessment of IRS examination and collection practices, concluding that many practices have been developed piecemeal and that the IRS lacks an effective overarching strategy to maximize voluntary compliance. The report also concludes that IRS collection practices often harm taxpayers without producing revenue.

In particular, the report cites IRS lien filing policies as the second most serious problem facing taxpayers. The IRS uses automated systems to file liens against taxpayers in a variety of situations, even when the taxpayer possesses minimal or no property and the lien will do little more than damage the taxpayer's financial viability and access to credit. A study conducted by Olson's office found no obvious causal relationship between the number of lien notices filed and the amount of overall revenue collected. Over the past decade, the IRS increased its lien filings by nearly 475 percent – from about 168,000 in FY 1999 to nearly

966,000 in FY 2009, yet overall inflation-adjusted collection revenue *declined* by 7.4 percent during this period.

A second study found that IRS procedures for determining a taxpayer's ability to pay outstanding tax liabilities may be driving some taxpayers into long-term noncompliance because the IRS fails to consider other debts such as credit card balances, school loans, and actual hospital or medical bills. Other tax systems, including Sweden's, consider the taxpayer's overall financial picture.

"Any taxpayer with these debts will tell you that these creditors don't go away," Olson said. "Taxpayers are placed in the intolerable position of agreeing to pay the IRS more than they can actually afford (given their other debts) and then defaulting on the IRS payment arrangements when they channel payments to unsecured creditors in order to get some peace. Thus, the IRS itself fosters noncompliance by its failure to take a holistic approach to the taxpayer's debt situation."

The National Taxpayer Advocate recommends that Congress require the IRS, before imposing a lien, to make a determination that the benefits of filing the lien outweigh the harm to the taxpayer and will not jeopardize the taxpayer's ability to comply with future tax obligations.

Data Concerns. The report expresses concern that the IRS does not maintain sufficient reliable data to assess the effectiveness of its collection practices in several respects. First, the IRS theoretically tracks the specific source of all payments received on delinquent accounts, but a TAS study found the majority of payments received either were not coded or were coded as coming from "miscellaneous" sources. The absence of this information makes a thorough assessment of the effectiveness of IRS collection practices impossible. Second, the amount of revenue the IRS collects is difficult to parse because the IRS itself uses multiple measures of what it calls "collection yield" or "enforcement revenue."

Third, the report states that the quality of IRS's data reporting is uneven. Olson's office found that the official IRS Data Book for FY 2008 revised collection revenue totals downward by \$32 billion, or 27 percent, for FY 2005, FY 2006, and FY 2007 combined, without explanation. "There is an astonishing lack of transparency as to what is included in these revenue figures and how they are computed," Olson said. "The failure to highlight and explain revisions of such magnitude erodes confidence in IRS's data reporting," she added.

Preparer Regulation. The report praises the IRS for moving ahead with plans to regulate federal income tax preparers. Olson called the plan, which the IRS issued earlier this week, a "significant, far-reaching initiative."

However, Olson expressed concern that one aspect of the plan may create a significant gap in the new rules that may be widely and increasingly exploited. Under current law, anyone may prepare a tax return for compensation, with no training, licensing, or oversight required. While attorneys, CPAs, and Enrolled Agents must pass difficult examinations to practice, others (known as "unenrolled preparers") are not required to do so. To protect taxpayers and improve tax compliance, Olson has proposed since 2002 that unenrolled preparers be required to register with the IRS, pass an examination, and complete periodic continuing education courses.

The IRS plan announced this week would impose these requirements on return preparers who sign tax returns but not on preparers who meet with taxpayers and prepare their returns if someone else signs them. To minimize cost and burden, a return preparation business may decide to employ one “signing” preparer who is certified under the new IRS rules and an unlimited number of “nonsigning” preparers. The nonsigning preparers would not have to register, pass an exam, or take continuing education courses, and the signing preparer would be unable to thoroughly review every return he signs (in part because the interview with the taxpayer is central to accurate preparation of the return).

Olson noted that the burden of the new rules themselves may cause more return preparation businesses to employ nonsigning preparers. “We are concerned that excluding nonsigning preparers could create an exception that swallows the rule,” the report states. The report notes that not all nonsigning preparers need to be covered to protect taxpayers and recommends that the IRS consider extending the new rules to apply to all *unenrolled* nonsigning preparers.

Rethinking the “Pay Refunds First, Verify Eligibility Later” Approach to Tax Returns Processing. Under current procedures, the IRS processes income tax returns before it processes most information returns, including Forms W-2, *Wage and Tax Statement*, and Forms 1099, which report interest, dividends, and other payments. “This sequence makes little logical sense,” the report states. From a taxpayer perspective, the sequence leads to millions of cases where taxpayers inadvertently make overclaims that the IRS does not identify until months later, exposing the taxpayer not only to a tax liability but to penalties and interest charges as well. From the government’s perspective, this sequence creates opportunities for fraud and requires the IRS to devote resources to recovering refunds that should not have been paid and that it often cannot recover. This sequence also prevents the IRS from making pre-populated returns available as an option to taxpayers.

The report recommends that Congress direct the Treasury Department to prepare a report identifying the administrative and legislative steps required to allow the IRS to receive and process information reporting documents before it processes tax returns. It recommends setting a goal of making these changes within six years.

Running Social Programs through the Tax System. Volume 2 of the report contains an analysis of social benefits provided through the tax code, with an emphasis on refundable credits. Refundable credits have been associated with high overclaim rates. However, the report states that where noncompliance involving refundable credits exists, the refundable nature of the credit is not the primary driver of the noncompliance. The report notes that some provisions of the tax code not involving refundable credits also are associated with high overclaim rates and concludes that the manner in which a provision is designed is a larger determinant of compliance rates than refundability. In particular, the IRS can more precisely administer tax benefits when the eligibility criteria reflect data that the IRS can verify through automation. The report proposes certain design elements to assist policymakers in enacting programs that maximize both participation and compliance.

The second volume of this year’s report also presents in-depth studies on the IRS’s use of notices of federal tax liens, the subsequent compliance behavior of delinquent taxpayers, and tax administration aspects of a consumption tax such as a value-added tax as well as an assessment of ombudsman offices across the Federal government.

Assessing tax administration today, Olson concludes that the IRS “is subject to three diverging forces – increased responsibility for non-core tax administration duties, increasing demand for taxpayer service (including telephone assistance) and declining resources to meet that demand, and collection policies that mask a *laissez faire* attitude toward taxpayer harm under the guise of ‘efficiency.’”

“The taxpayer is wedged in the middle of these forces, being pulled in all directions, but never the right one,” Olson writes.

Federal law requires the National Taxpayer Advocate to submit an Annual Report to Congress each year identifying at least 20 of the most serious problems encountered by taxpayers and to make administrative and legislative recommendations to mitigate those problems. Overall, this year’s report identifies 21 problems, provides updates on two previously identified issues, makes dozens of recommendations for administrative change, proposes 11 recommendations for legislative change, and analyzes the 10 tax issues most frequently litigated in the federal courts during the past fiscal year.

About the Taxpayer Advocate Service

The Taxpayer Advocate Service (TAS) is an independent organization within the IRS whose employees assist taxpayers who are experiencing economic harm, who are seeking help in resolving tax problems that have not been resolved through normal channels or who believe that an IRS system or procedure is not working as it should. If you believe you are eligible for TAS assistance, you can reach TAS by calling the TAS toll-free case intake line at 1-877-777-4778 or TTY/TDD 1-800-829-4059. For more information, go to www.irs.gov/advocate.

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